

DEC 14 1992

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

J. BARON GROSHON
BY: 
Deputy Clerk

In Re:) Case No. 91-10607
) Chapter 11
FRANK W. KASEY and)
ZELDA T. KASEY,)
)
Debtors.)

JUDGEMENT ENTERED ON DEC 14 1992

**ORDER OVERRULING DEBTORS'
OBJECTION TO PROPOSED ORDER**

This matter is before the court on the debtors' objection to the proposed order concerning the claim of Southern Concrete Materials, Inc. in the debtors' bankruptcy case. At a hearing on September 23, 1992 the court determined the amount of Southern's claim, however the status of the claim for purposes of classification in the bankruptcy plan was not specifically addressed. The proposed order in response to the September 23, 1992 hearing established Southern's claim as a secured claim. The debtor objected to the proposed order asserting that Southern does not have a secured claim. After a hearing on the objection to the proposed order and a review of the record the court concludes that Southern has a claim against the debtors for \$13,770.95 secured by real property.

FINDINGS OF FACT

1. Frank and Zelda Kasey along with their various business entities, filed this bankruptcy petition on October 25, 1991.
2. In September 1990, Western Carolina Tank Disposal Company ("Western") and its owner Dennis Corn, began the installation of several gas tanks for a gas station on Highway 25 in

Henderson County, North Carolina for the debtors (the station property).

3. As part of the installation process Western did the grading and concrete work for the gas station.¹

4. Dennis Corn purchased \$13,770.95 worth of concrete for the station from Southern which remained unpaid at the time the debtors filed bankruptcy.

5. Dennis Corn did not have a North Carolina General Contractor's License at the time he performed the work for the debtors.

6. On November 21, 1990, Southern filed a Claim of Lien in Henderson County against the station property of Frank and Zelda Kasey for concrete supplied to the debtors for the gas station pursuant to §§ 44A-12 and 44A-23 of the North Carolina General Statutes.

7. On December 6, 1990, Southern filed a Cancellation and Substitution of Claim of Lien. The substitution was a Notice of Claim of Lien by First Tier Sub-Contractor pursuant to N.C. Gen. Stat. §§ 44A-18 and 44A-19. The Notice also contained a standard paragraph reserving "all rights of subordination to which [the lien claimant] is entitled under Part 2 of Article 2 of Chapter 44A of the General Statutes of North Carolina."

¹ There is some dispute as to whether Western had a separate agreement to perform the grading and concrete work. The resolution of that issue is irrelevant to the issue before the court today.

8. On March 15, 1991, Southern instituted action against the Kaseys in Henderson County to enforce their claim of lien.

9. Before the lawsuit could be reduced to judgment, the debtors filed for bankruptcy.

10. On February 21, 1992, Southern filed a Proof of Claim in the debtors' bankruptcy case and claimed to be a secured creditor with a lien on proceeds owed to Dennis Corn.

11. The debtors objected to Southern's claim as filed and after a hearing on the matter the court set the amount of Southern's claim at \$13,770.95; however, the secured status of the claim was not determined.

CONCLUSIONS OF LAW

The central issue before the court is whether Southern has a secured or unsecured claim in the debtors' bankruptcy case. Southern claims to be a secured creditor by virtue of its December 6, 1990 Notice of Claim of Lien and the attempted enforcement of that lien against the debtors in March 1991. Southern asserts that the claim of lien operated as a claim of lien on funds owed to Dennis Corn and a claim of lien on the station property owned by the debtors. The debtors contend that Southern does not have an enforceable lien on the station property because the debtors have an affirmative defense against the enforcement of such a lien that Dennis Corn was not a licensed contractor by the State of North Carolina at the time he performed the work for the debtors. Without an enforceable lien against the debtors, Southern would have an unsecured claim in the debtors' bankruptcy

case. The court concludes that Southern has a lien on funds owed to Dennis Corn pursuant to N.C. Gen. Stat. § 44A-18 and a lien on the debtors' station property pursuant to § 44A-23. Accordingly, Southern has a secured claim in the debtors' bankruptcy case for \$13,770.95.

A. Southern's Status Pursuant to N.C. Gen. Stat. §§ 44A-7 - 44A-23

A subcontractor may assert two liens under Chapter 44A for labor and/or materials that the subcontractor provided but for which it was not paid. The first is a lien on funds owed to the general contractor pursuant to a contract entered into between the owner of the real property, where the labor and materials were furnished, and the general contractor. 8 N.C. Gen. Stat. § 44A-18. To the extent that there are funds owing to a general contractor, a subcontractor may perfect a lien on those funds by providing the owner of the property with notice of the claim of lien pursuant to § 44A-19. *Id.* at § 44A-19. The second lien is the lien of the general contractor on the real property where the labor and materials were furnished by way of subrogation pursuant to § 44A-23. *Id.* at § 44A-23.² The general contractor is entitled to a lien on real property for labor and materials provided to the owner for which the contractor has not been paid. Section 44A-23 allows a subcontractor to assert the contractor's lien by

² Section 44A-23 was amended effective for filings made after July 22, 1992. Because the events in this case occurred prior to that date, the former version of § 44A-23 is the proper version for the court to consider. Notwithstanding, the changes in the statute are immaterial to the issues in this case.

subrogation provided the subcontractor complies with the notice and perfection requirements of the statute. The subcontractor is barred by the defenses available to the owner against the general contractor. *Con Co., Inc. v. Wilson Acres Apts, Ltd.*, 56 N.C. App. 297, 289 S.E.2d 633, 635, cert. denied, 306 N.C. 382, 294 S.E.2d 206 (1982).

In the instant case the debtors contracted with Western and Dennis Corn, the contractor, for the installation of several gas tanks for a gas station owned by the debtors. As part of the installation process Dennis Corn purchased concrete from Southern which was delivered and poured at the gas station. Southern was not paid for a portion of the concrete provided and after some attempt to collect the amount due, Southern timely filed a Claim of Lien in the office of the clerk of Henderson County, North Carolina, pursuant to § 44A-12 for a lien on the real property of the debtors. Southern canceled the Claim of Lien and timely substituted a Notice of Claim of Lien by First Tier Sub-Contractor pursuant to § 44A-19 for a lien on funds, § 44A-18, and purportedly for a lien on real property, § 44A-23.

The Notice of Claim of Lien clearly supports Southern's lien on funds pursuant to § 44A-18 and the court finds that Southern has a statutory lien on funds owed to Dennis Corn. In addition, the Notice of Claim of Lien included a paragraph whereby Southern "claim[ed] all rights of subrogation ... under Part 2 of Article 2 of Chapter 44A of the General Statutes of North Carolina." The contractor's lien on real property that is subrogated to subcon-

tractors is located in Part 2 of Article 2 of Chapter 44A. Although Southern should have filed a Claim of Lien pursuant to § 44A-12 or included its provisions in the Notice of Claim of Lien to perfect its lien on the station property, the court concludes that the filing of the Notice of Claim of Lien is sufficient as between the parties and the bankruptcy estate to create a perfected statutory lien on the station property pursuant to § 44A-23. 8 N.C. Gen. Stat. § 44A-23 ("The lien is perfected as of the time set forth in Gen. Stat. 44A-10 upon filing of claim of lien pursuant to N.C. Gen. Stat. 44A-12") (emphasis added).

1. Extent of Southern's Liens

Southern's lien, whether on the proceeds owed to Dennis Corn or on the real property of the debtors, is limited to the extent that there were funds owing to Dennis Corn as of the date Southern noticed or filed its claim of lien. *Electrical Supply Co. v. Swain Ele. Co.*, 328 N.C. 651, 403 S.E.2d 291, 293, 297. At the time of the filing Dennis Corn was owed one-third of his contract with the debtors, or \$16,403.37. Accordingly, Southern has a lien on its entire claim of \$13,770.95.

2. Effect of Non-Licensed General Contractor

Another possible limitation on Southern's liens arises from the fact that Dennis Corn was not a licensed general contractor at the time he performed the work for the debtors. Southern's claim of lien on the station property is, in fact, a subrogated interest to the lien accorded the general contractor. Generally,

anyone who enters into a contract for a fixed price to construct a building or improvement for a sum of \$45,000 or more is deemed a "general contractor" pursuant to North Carolina General Statute 87-1. 11 N.C. Gen. Stat. § 87-1.³ North Carolina courts have uniformly held that a general contractor within the meaning of § 87-1, who is not licensed pursuant to statute, may not recover against the owner of the property for breach of the construction contract itself or on quantum meruit. *Builders Supply v. Midyette*, 274 N.C. 264, 162 S.E.2d 507, 512 (1968); *C.C. Walker Grading & Hauling, Inc. v. S.R.F. Management Corp.*, 311 N.C. 170, 316 S.E.2d 298, 302 (1984).

This rule provides the owner of the real property with an affirmative defense against the unlicensed general contractor who attempts to assert a lien pursuant to § 44A-23 on the real property. The subcontractor, as subrogee, is limited to the rights and interest of the unlicensed general contractor. *Con Co, Inc. v. Wilson Acres Apts, Ltd.*, 56 N.C. App. 297, 289 S.E.2d 633, 635, cert. denied, 306 N.C. 382, 294 S.E.2d 206 (1982). Theoretically then, the owner would have the same affirmative defense against the subcontractor's attempt to assert the contractor's lien against the real property pursuant to § 44A-23.

It is possible to argue that a subcontractor's direct lien on funds owed to the general contractor could also be barred by

³ Section 87-1 was amended effective July 6, 1992 to reflect a change in the minimum contract price from \$45,000 to \$30,000. Because the events in this case occurred prior to that effective date the \$45,000.00 value is the proper contract price for the court to consider.

the licensing defense. If the unlicensed general contractor could not collect on the contract, there may be no funds owed to the contractor for the subcontractor's lien to attach.

The effect of the licensing statute for subcontractors claiming liens under a right of subrogation was addressed in *Zickgraf Enters., Inc. v. Yonce*, 63 N.C. App. 166, 303 S.E.2d 852 (1983). The defendant homeowners appealed the denial of their motion for summary judgment against a first tier subcontractor claiming a lien under a right of subrogation from an unlicensed general contractor.⁴ The homeowners argued that the failure to be licensed was a bar against the subcontractor's attempt to assert a lien because the lien rights were contingent on the viability of the contract between the owners and the general contractor. The court concluded that this application of the licensing statute was not appropriate because it was outside the scope of persons intended to be regulated. *Id.* at 167.

The failure of a general contractor to be licensed does not render 'void' the contract between the contractor and the owner. The nature of the transaction is still extant, with the proviso that in an action brought against the owner by the general contractor, the owner may assert against the general contractor the affirmative defense of failure to be properly licensed. This

⁴ It is unclear from the opinion whether the subcontractor was claiming a lien pursuant to § 44A-18 or § 44A-23. A review of the pleadings in the case revealed that the subcontractor was asserting a lien pursuant to both statutes. The language of the opinion seems to address only the "rights of subrogation accorded a first tier subcontractor under Article II of Chapter 44 of the North Carolina General Statutes." *Id.* at 167. Section 44A-23 is the only section that concerns the subrogation rights of a first-tier subcontractor. Section 44A-18 deals with subrogation but only with respect to second-tier and more remote subcontractors.

fulfills the purpose of the licensing statute which is the protection of the public against incompetent builders. The licensing statutes should not be used as a shield to avoid a just obligation owed to an innocent party. . . We perceive no injury to the public, as contemplated by the licensing statutes, which will arise from the enforcement of a lien by a subcontractor where the lien arises out a valid contract between an unlicensed general contractor and a property owner.

Id. at 168 (citations omitted). On this basis the court affirmed the trial court's denial of the homeowners' motion for summary judgment. *Id.* Although it is unclear which subcontractor lien statute was being addressed in the opinion, we believe the court would have come to the same conclusion under either statute.

According to *Zickgraf*, the fact that Dennis Corn was an unlicensed general contractor when he performed the work for the debtors is not a bar to Southern's attempt to assert its lien on funds owed to Corn or to assert Corn's lien on the debtors' station property.

Southern has a lien for \$13,770.95 on funds owed to Dennis Corn pursuant to § 44A-18 and a lien on the station property pursuant to § 44A-23.

B. Treatment of the Statutory Lien in Bankruptcy

1. Viability of the Lien - § 545

Section 545 of the Code allows the trustee to avoid statutory liens upon certain circumstances. Subsection 545(2) is the only subsection that is applicable to the present case and provides that the trustee may avoid a statutory lien that is not perfected at the time of the commencement of the case. The state of perfection as of the petition date is determined by state law.

Allgeier & Dyer, Inc. v. City of Bowling Green, Ky. (In re Allgeier & Dyer, Inc.), 18 B.R. 82, 88 (Bankr. W.D. Ky. 1982).

Southern's lien on funds was perfected pursuant to §§ 44A-18 and 44A-19 on December 6, 1990 upon the filing of the Notice of Claim of Lien by First Tier Subcontractor. To perfect a lien on funds the lien claimant must give the obligor, in this case the debtors, notice in writing of their claim of lien which conforms to the statutory form noted in § 44A-19. Southern substantially complied with the notice requirement and therefore has an unavoidable, perfected statutory lien on funds owed to Dennis Corn.

Perfection of a lien on real property is governed by §§ 44A-10, 44A-11, and 44A-12. Section 44A-10 sets the effective date of the lien at the time the contractor first furnished labor or materials to the site. Section 44A-11 provides that the lien is perfected upon the filing of the claim of lien pursuant to § 44A-12. Because there is no dispute as to priority of the lien, the effective date of the lien is immaterial except to note that it was prior to the filing of the debtors' bankruptcy petition. Although Southern is claiming the lien on the station property as subrogee of Dennis Corn, the statute provides that Southern must follow the same perfection procedures as required for the contractor. 8 N.C. Gen. Stat. § 44A-23. Southern did not file a claim of lien pursuant to § 44A-12. Southern did, however, file its Notice of Claim of Lien in Henderson County which the court considers adequate notice to the debtors that Southern claimed a lien on the station property. Thus, Southern's lien on the

station property was perfected under state law at least as early as December 6, 1990 when Southern filed the Notice of Claim of Lien. Because Southern had a perfected lien prior to the commencement of the debtors' bankruptcy case, the trustee may not avoid the lien.

C. Secured Status § 506

Whether a creditor has a secured or unsecured claim in bankruptcy is determined by § 506 of the Code. The "allowed claim of a creditor secured by a lien on property in which the estate has an interest ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property." 11 U.S.C. § 506(a). Southern has two liens in the instant case; a lien on funds owed to Dennis Corn and a lien on real property of the debtors. The lien on funds owed to Dennis Corn is most likely worthless. The funds do not exist. There is no res for the lien to attach.

The lien on the station property is much more tangible and more easily ascertained. Southern has an allowed claim for \$13,770.95 as determined by the court in the previous hearing. The value of Southern's secured claim depends on the value of the station property. Although there was not much evidence presented at the hearing on the value of the station property, it is safe to assume that there is at least \$13,770.95 of equity in the property.

D &. Conclusion

Southern is entitled to a secured claim in the debtors' bankruptcy case in the amount of \$13,770.95. Southern has a valid perfected lien on funds owed to Dennis Corn (to the extent that they exist) and on the station property. The liens are not avoidable under § 545. Although the lien on funds is of questionable value, the lien on the station property is fully secured.

It is therefore ORDERED that:

1. The debtors' objection to the proposed order tendered by Southern is hereby OVERRULED; and
2. Southern has a secured claim in the debtors' bankruptcy case for \$13,770.95.

This the 14th day of December, 1992.



George R. Hodges
United States Bankruptcy Judge